



Washington, D. C. 20505

DDI- 00195/85/2

29 JAN 1985

Dr. Ivan Selin
Chairman
American Management Systems, Inc.
1777 North Kent Street
Arlington, VA 22209

Dear Ivan:

Thank you for your recent report on the latest round of meetings on the community's estimates of Soviet defense outlays. I am particularly pleased that you devoted some time to DIA's work at this meeting and look forward to hearing more from you as you complete your assessment of their work. The existence of separate defense estimates developed by DIA and CIA presents a real problem for intelligence consumers who are not knowledgeable about this work. We clearly need to improve our understanding of the relationship between these estimates. Through its past work, your Panel has compiled a comprehensive assessment of the work done in SOVA. Once you've completed a similar review of DIA's program in this area, we should be in a good position to understand how best to improve the research process in this area and the intelligence products as well.

Your remarks on publication of our dollar cost comparisons of US and Soviet defense activities and on open publication of Agency analysis touch on difficult problems, as you well know. I believe the motivation behind our decision reached last July, not to publish dollar comparisons, was sound. It can be well documented that this analysis was often misused in the past. Since July, however, we have been periodically revisiting the decision as new requests for the data are received and a better picture of consumer needs and ways to meet them emerge. As it now stands, Bob Gates has agreed to provide a classified summary statement of our current comparisons and supporting data to the JEC in response to a request from Senator Proxmire. Copies of this material also are being sent to key members of the Executive Branch and will be made available to you and members of the Panel. In addition, Bob recently held discussions on comparative defense costs with senior officials of the Department of Defense and has agreed to provide additional material as requested by them. We will continue to examine the usefulness of releasing these estimates on a case-by-case basis.

B-232

Dr. Ivan Selin

On the issue of unclassified reporting, Bob Gates has tasked SOVA to recommend appropriate reports from its regular research program for issuance as open publications. When we determine that there are no problems from a security standpoint and that it is in the best interest of the Intelligence Community and the public to publish a paper unclassified, we will try to do so.

As always, I appreciate your efforts and counsel.

Sincerely,

/s/ William J. Casey

William J. Casey
Director of Central Intelligence

DDI- 00195-85/1

23 JAN 1985

MEMORANDUM FOR: Director of Central Intelligence
FROM: Deputy Director for Intelligence
SUBJECT: Response to Ivan Selin's Report on the Last Meeting of Your
Military-Economic Advisory Panel (MEAP)

1. We have reviewed the recent report from Ivan Selin, Chairman of the MEAP, and for the most part find Dr. Selin's comments useful. Accordingly, SOVA has prepared the attached response for your signature.

2. The Panel has recommended several procedures for resolving differences between CIA and DIA analysis. The response asks the Panel to complete its assessment of DIA's work before we begin to consider its specific recommendations. The Panel also continues to press for publication of more unclassified reporting on the USSR and presentation of dollar cost comparisons of US and Soviet defense activities. As the response indicates, we are moving on the first recommendation and giving due consideration to the second.

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Robert M. Gates

Attachment:
As Stated



American Management Systems, Inc.

Ivan Selin
Chairman

December 17, 1984

The Honorable
William Casey
Director
Central Intelligence Agency
Washington, D.C. 20505

Dear Bill:

Your MEAP held its fall meeting on November 30 and December 1. A number of points came out of this meeting, likely to be of interest to you and your senior staff. In particular, we followed your request and spent half the meeting at DIA. This produced a very illuminating session concerning their ways of doing business; we have several suggestions on ways to improve CIA/DIA interaction.

CIA/DIA Interaction

We have been increasingly concerned about the apparent inability of CIA and DIA to reconcile the differences between their respective estimates of Soviet military expenditure. Our meeting with DIA leads us to believe that there are difficult problems of narrowing the differences in the major area of DIA's military economic activity, Soviet ruble outlays and the burden of defense, which we discuss below. However, in the area of dollar estimates of procurement, there are considerably brighter prospects, if the principals can demonstrate the required good will.

Dollar Value of Procurement. First, there are simple differences of methodology between the two organizations. Both use the same base price to value the same piece of Soviet hardware, but they handle learning curves differently. CIA takes the marginal cost for the units of a weapon system bought in a given year, while DIA uses the lifetime average costs for the weapons system. If there were no other differences than this one, DIA's estimates of procurement growth would always be higher than CIA's.

The two agencies also calculate learning curves differently. DIA treats a weapon system (e.g. the Mig 27) as a unit, whereas CIA calculates learning on individual major sub-systems, such as each engine used in more than one aircraft model. These differences revolve around important conceptual issues, but we believe they can be resolved. There is no reason in principle why the two agencies should not be able to agree on a common methodology. They should be tasked to do so.

A second area of differences is in production quantities. Often both agencies agree on the order of battle for a weapon system, but not on the production quantities or the start dates for future systems. Here a solution is made more difficult by the administrative separation of the responsibility for OB and production estimates in DIA. At the very least, analysts from both organizations should continue to meet regularly to discuss differences and narrow the range of disagreement as well as they can. More formally, it would be desirable to reactivate the joint CIA/DIA Military Costing Review Board, or create another working group in its place, to deal with these problems on an ongoing basis. In any case, it is highly desirable that in the event of CIA/DIA disagreement, the policy consumers know where the agencies disagree and to what effect. That can be accomplished by appropriate appendixes in the reports of both organizations.

Ruble Military Expenditure. The basic methodologies of the two organizations are totally different, so there can be no direct reconciliation of the estimates. DIA's estimates are based on an assumption that is said to be supported by several other approaches, each of which is individually subject to considerable estimating error. Our initial impression is that there are important questions about the reliability of the DIA approaches, but we will have specific recommendations to make to DIA over the coming months as we familiarize ourselves with the details of their methodology (we have been promised complete documentation of the estimates).

The only way to compare directly the CIA estimates -- valued in 1970 prices and estimated from the bottom-up -- with those of DIA -- derived from Soviet aggregated data in current prices -- is by a set of indexes translating 1970 prices into those of a recent year, say 1982. as you know, SOVA is now attempting to do just that through a variety of approaches. From the viewpoint of improving CIA/DIA communication and understanding of their respective estimating approaches, it will be important at an appropriate stage to subject the CIA study of price changes to peer review in DIA.

CIA Policy

There are two areas of CIA policy where we think changes could serve the interests of all parties concerned. The first relates to preparing and publishing, at suitable levels of classification, estimates of the dollar cost of Soviet military activity.

Put simply, the current policy is to do the analytical work necessary for estimating the dollar values, but not to prepare or publish the comprehensive document. Instead, CIA stands ready to respond to requests for information from qualified consumers, e.g., DoD staff or congressional committees. The stated reason for this policy is to prevent misuse of CIA work.

While we can sympathize with the objective, the policy is self-defeating. On the practical level, if the information is to be made available on request anyway, CIA would be better advised to keep the initiative and determine the form of presentation, not merely react to questions. CIA publication permits introduction of suitable caveats; it also makes possible alternative estimates and a much richer presentation. Of course the results presented in a CIA publication can still be misused, but not as easily as a response to an outside request. In addition, we do have some suggestions on how the published reports can minimize some of the more flagrant abuses, which are appended at the end of this letter.

But our objections to this policy go deeper. They have to do with the credibility and consistency problems implicit in a stop-and-go policy of changing the estimates published from year to year in an erratic fashion. The CIA has published a standard set of estimates, consisting of various dollar and ruble series, as well as reports on manpower and other resource categories, as the community-wide basis for a wide variety of intelligence products. Ruble Soviet outlays, the "burden" rates, dollar and ruble comparisons of the U.S. and the U.S.S.R., manpower and resource comparisons -- these are components of an integral product -- a comprehensive, economic description of Soviet military activity. Each component individually makes its own contribution to the all-round analysis. Together, fitted into a particular conceptual framework, they provide the most thoroughgoing picture of the Soviet military effort that can be produced in the West. To delete one or another of these components is to damage the integrity and utility of the estimate package as a whole.

The closest analogy would be the Bureau of Labor Statistics not publishing some unemployment series because of misuse by a congressional committee, an event that the Department of Labor would go to great pains to avoid. The CIA estimates have attained a high degree of credibility and utility, both in the government and, when appropriate, outside. We strongly urge that the Agency return to its tried and proven program of research and publication in military-economics.

The second policy which we would like to discuss concerns open publication. You are aware of our concerns in this area, and our belief that is possible to fashion a policy that continues to maintain an embargo on publishing policy analyses, but does contribute non-policy, unclassified research to the general body of knowledge. We have suggested to Bob Gates a number of reports, published from 1982 to the present, which could have been presented in unclassified form with varying but still reasonable sanitization.

We have discussed both these topics with Bob and were encouraged by his response. He has also asked us to review the progress of the increased efforts that you have invested into understanding and explaining Soviet defense industries. We will work on this question over the next six months, and report after the spring MEAP meeting.

Specific Topics

1. When you met with the Panel in the spring you asked us about new members. We have since added two -- [] an expert on Eastern Europe, and [] who combines a background in political science with good technical and industry background. [] will be a help in many areas, including the area of Soviet defense industries.
2. We hope that [] will help in one area which needs further emphasis, i.e. the coordination of Soviet-Eastern Europe economic analysis. It is clear that this has become a very important area and, because of the SOVA/EUR partition, one that requires greater management emphasis to achieve a level of coordination and joint work.
3. Another area where further integration is required is in the melding of policy and political analysis with economic analysis. In the major area of Soviet decision making in a time of economic stringency, it is essential that the mode of thinking of the economic analysts be more deeply affected by political considerations and an awareness of policy alternatives. We will work directly with SOVA in this area to give concrete examples and recommendations.
4. We were pleased to see continued, encouraging evidence of SOVA's attempts to use economic analysis and resource considerations, to inform the projections of the force analysts.
5. R&D estimates are another area where important progress appears to be continuing, particularly in shifting away from the old, inconsistent methodology towards one more consistent with other estimates. We were also pleased to have learned that SOVA will be sponsoring a conference of outside experts to help in charting a course in this difficult area.
6. One of the most fruitful ways to improve projections is retrospective analyses -- systematically reviewing previous years' projections to understand where and why mistakes were made. This is particularly important when major changes in trends are expected. Currently, there is a strong feeling that Soviet procurement is starting to increase again. Projections for each of the last several years have shown the same ramp effect, but no such change has been seen. SOVA is already studying the flattening of procurement from 1976 to 1982 to explain why the Soviets did what they did; we would like to see the study broadened to see why we were slow to recognize the change, and why we have forecast but not seen an upturn for each of the last three years.

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7. Another topic that deserves increased emphasis is that of indicators of change in military-economic activity. When the data are ambiguous and the intelligence community decides on balance that one of several plausible projections is the most likely, the analysts should not stop there. Rather they should continue to home in on differences that should be observed if the accepted projection proved wrong.

For instance the community now feels, based on highly ambiguous data, that Soviet military procurement is starting once again to rise. Some effort should be expended now to sharpen the projection by identifying indicators which should be examined in the next year or so to see if this growth projection appears to be coming true.

These are the major points of our review. We are working directly with SOVA and with DIA on particular points of more localized impact on each respective organization. Please do not hesitate to call on us for further information, support, or examination of any of these points.

Sincerely,

A handwritten signature in cursive script, appearing to be 'Wm'.

APPENDIX

How CIA Can Help Limit the Misuse of its Estimates

We have a number of suggestions for changes in presentation of the CIA's military-economic estimates that should help to curb their misuse. These ideas are not new; the Panel has advanced them at various times in the past. However, we believe they remain valid. Moreover, their relevance and possible utility are underscored by the problems of improper use CIA has experienced in recent years.

We will not deal here with misunderstandings about the methodology of the estimates, which is a separate and difficult problem to deal with. We confine ourselves to just misinterpretation of the results. Although there are many such errors, it appears to us that four are of major significance:

1. Measures of resource costs are misinterpreted as indicators of military capability.
2. Estimates of the dollar cost of Soviet activity are misinterpreted as indicators of Soviet "spending".
3. The Soviet-American ratio of costs in dollars is treated as if it were the "true", uniquely valid comparison, instead of being one of two equally valid comparisons that will tend to produce a higher ratio than a ratio of the two sides valued in rubles.
4. Rates of growth of Soviet ruble expenditure are confused with rates of growth of the dollar cost of Soviet activity.

Again, it is not possible to guarantee against misuse and misinterpretation, particularly where political objectives are being served. However, the following suggestions should make abuses more difficult and thereby, perhaps, more self-evident, since the misuser will have to twist the results to make his case.

1. If dollar costs of Soviet activity must be presented alone, * show them only in the form of index numbers on a past base year, say 1980. This at least prevents the direct citation of absolute values which are then attributed as "CIA estimates of Soviet spending" (misuse no. 2).

*The only valid purpose of dollar valuation is for comparative analysis. Occasionally, dollar valuation may be necessary as a crude proxy for a ruble series. When dollars are used as a surrogate, the implications, in terms of likely differences with the missing ruble indicators, should be highlighted.

2. Toward the same end, present dollar cost comparisons (U.S.-U.S.S.R.) only in the form of ratios, not absolute dollar values. Show ratios of cumulative sums along with ratios for particular years.

3. Better still, always juxtapose ruble with dollar cost -- comparisons -- i.e., ratios of Soviet-to-American (or American-to-Soviet) costs of activity based on ruble as well as dollar valuation of both sides. This, of course, meets the problem of misuse no. 3. But it also accomplishes two other purposes: it makes it much more difficult to talk about Soviet "spending" in a comparative framework, and the user who wishes to interpret comparative value estimates as indicators of capability (misuse no. 1) will be forced to confront the difference in magnitude between ruble-based and dollar-based ratios.

4. Where possible, avoid using rates of growth in the analysis of dollar costs of Soviet activity, presented without the counterpart ruble expenditure. Wherever possible and sensible, cite the rates of growth of both dollar costs and ruble expenditure and explain the reasons for the differences.

5. Present alternative or variant calculations along with the basic series. Such variants not only enrich the analysis but also help prevent misinterpretation. For example, analysis of the dollar costs of Soviet personnel at present-day prices might be complemented with a variant using U.S. pay and allowance rates in a year when the draft was still in effect, and compare that series with (a) one for the United States using the same weights and (b) ruble-weighted valuations of U.S. and Soviet costs. Such a set of calculations would not only deal with the often-heard charge that CIA exaggerates Soviet manpower costs by using high U.S. pay rates, but it would also call attention to the resource cost basis of the calculations; one cannot easily discuss the relative "capability" of two forces when its measure has at least four different answers.